

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO.2004-357-WS - ORDER NO. 2005-___

JUNE ___, 2005

RE: Application of Carolina Water Service,)	
Inc. for adjustment of rates and charges)	PROPOSED ORDER OF
and modification of certain terms and)	CAROLINA WATER SERVICE,
conditions for the provision of water and)	INC.
sewer service.)	

I. INTRODUCTION

This matter is before the Public Service Commission of South Carolina (“Commission”) on the Application of Carolina Water Service, Inc. (“CWS” or “Company”) for approval of a new schedule of rates and charges and modifications to certain terms and conditions for the provision of water and sewer services for its customers in South Carolina. CWS filed its Application on December 17, 2004, pursuant to S.C. Code Ann. § 58-5-240 (Supp. 2003) and 26 S.C. Code Ann. Regs. RR. 103-503 (1976), 103-703 (1976), 103-512.4.A (Supp. 2003) and 103-712.4.A (1976, as amended).

By correspondence, the Commission’s Docketing Department instructed CWS to publish a prepared Notice of Filing, one time, in a newspaper of general circulation in the area affected by CWS’s Application and to mail copies of the Notice of Filing to all customers affected by the proposed rates and charges and modifications. The Notice of Filing indicated the nature of the Application and advised all interested parties desiring to participate in the scheduled proceeding

of the manner and time in which to file the appropriate pleadings. CWS filed affidavits showing that it had complied with the Docketing Department's instructions.

Petitions to Intervene were subsequently filed on behalf of the South Carolina Department of Health and Environmental Control ("DHEC") and Midlands Utilities, Inc. ("Midlands"). The Commission received letters of protest from fifty-four (54) CWS customers. The South Carolina Office of Regulatory Staff ("ORS"), a party of record pursuant to S.C. Code Ann. § 58-4-10(B) (Supp. 2004), made on-site investigations of CWS's facilities, audited CWS's books and records, issued data requests, and gathered other detailed information concerning CWS's operations.

The Commission held four (4) separate public hearings in Dorchester, York and Lexington counties for the purpose of allowing CWS's customers to present their views regarding the Application.¹ A total of forty-nine (49) customers testified at these hearings. Thereafter, on May 4, 2005, at 10:30 a.m., an evidentiary hearing was convened before the Commission in its offices in Columbia with the Honorable Randy Mitchell presiding. CWS was represented at the hearing by John M.S. Hoefer, Esquire. Charles H. Cook, Esquire, represented Midlands. Jessica J.O. King, Esquire represented DHEC. Florence P. Belser, Esquire, and Lessie C. Hammonds, Esquire, represented the ORS. Prior to the presentation of the cases of the parties of record, the Commission permitted nine (9) customers to testify, eight (8) of whom had

¹ These hearings were held April 18, 2005 in Summerville, April 20, 2005 in Irmo, April 26, 2005 in the Lake Wylie area of York County, and May 2, 2005 in the Oak Grove area of Lexington County. Pursuant to directions of the Commission's Docketing Department, notice of

not spoken at any of the previous public hearings. CWS presented the direct and rebuttal testimony of three (3) witnesses: Bruce T. Haas, CWS Regional Director of Operations; Steven M. Lubertozi, CWS Director of Regulatory Accounting; and Pauline M. Ahern, CRRA, Vice-President of AUS Consultants – Utility Services. Midlands presented the direct and surrebuttal testimony of Keith G. Parnell. No testimony was presented by DHEC, although it made an offer of proof by way of a proffer of the pre-filed direct testimony of Jeffrey P. DeBessonet, P.E.² ORS presented the direct testimony of Willie J. Morgan, P.E., the Program Manager for its Water and Wastewater Department; Dawn M. Hipp, a Program Specialist in the ORS Water and Wastewater Department; and Sharon G. Scott, Auditor for ORS. Also, ORS presented the direct and surrebuttal testimony of Ben Johnson, PhD. of Ben Johnson Associates, Inc. The evidentiary hearing was completed on May 5, 2005.

In considering the Application of CWS, the Commission must consider competing interests to arrive at just and reasonable rates. These competing interests are those of the ratepayer and those of the utility, which has the right to earn a fair return. *S.C. Cable Television Ass'n v. Public Serv. Comm'n*, 313 S.C. 48, 437 S.E.2d 38 (1993). In so doing, we may consider

these hearings was given to affected customers by the Company as reflected in an affidavit filed by the Company.

² On April 25, 2005, CWS filed and served a motion seeking an order of the Commission prohibiting DHEC from introducing Mr. deBessonet's prefiled testimony into evidence or making it part of the record in this case. By order of its duly appointed Hearing Officer, Commission Chief Clerk and Administrator Charles L.A. Terreni, dated April 28, 2005, the Commission granted CWS's motion to the extent that it sought to preclude the reception of Mr. deBessonet's testimony as evidence. However, Mr. Terreni's order permitted an offer of proof by DHEC. At hearing, CWS made a conditional offer of proof by way of a proffer of the rebuttal testimony pre-filed by Mr. Lubertozi in response to Mr. deBessonet's testimony.

the quality of the utility's service, which is determined by reference to its adequacy. *Patton v. S.C. Public Serv. Comm'n*, 280 S.C. 288, 312 S.E.2d 257 (1984). Regulation, as it has developed in the United States, is concerned with rates, service, [and] safety. Charles F. Phillips, Jr., *The Regulation of Public Utilities*, (1993) at 171. Rate regulation has two aspects: control of the rate level (earnings) and control of the rate structure (prices). *Id.* As to the rate level, public utilities are entitled to cover all allowable operating costs and to have the opportunity to earn a "fair" rate of return. *Id.* Collectively, these items comprise a company's total revenue requirements. *Id.* As to the rate structure, public utilities are permitted to establish rates that, at a minimum, will cover their revenue requirements. *Id.* at 171-72. Such rates must be "just and reasonable," with no "undue" discrimination. *Id.* at 172.

Thus, in considering the Application of CWS, the Commission must give due consideration to the Company's total revenue requirements, comprised of allowable operating costs and the opportunity to earn a fair rate of return. To this end, the Commission will review the operating revenues and operating expenses of CWS and will endeavor to establish adequate and reasonable levels of revenues and expenses. Further, the Commission will consider a fair rate of return for CWS based upon the record before it. Should the Commission's determination show that rates should be increased, the Commission will then design rates that will meet the revenue requirements of CWS but that are also just and reasonable and free of undue discrimination.

II. PRELIMINARY MATTERS

A. THE CWS MOTION TO STRIKE

By written motion and supporting memorandum dated April 26, 2005, CWS moved the Commission for an order striking statements of customers made at hearings in this docket complaining of sewer backups.³ The Commission heard argument on the motion by CWS prior to the start of its case in chief. [Tr. p. 86, l. 18 – p. 94, l. 13; Tr. p. 97, l. 5 – p. 106, l. 20.] None of the other parties of record opposed the Company's motion. [Tr. p. 94, ll. 14 – 16; p. 129, l. 16 – p. 130, l. 23.] The Commission reserved ruling on this motion and advised the parties that it would address it in its final order in this matter. [Tr. p. 130, l. 24 – p. 131, l. 3.]

The Commission concludes that the Company's motion should be granted. Essentially, the motion to strike raises the issue of whether a complaint regarding sewer backups resulting in damage to customer property is properly considered in the instant case. We conclude that it is not for several reasons. First, there is the question of whether notice was given that customer complaints regarding sewer backups would be considered in the context of this rate application proceeding. We are persuaded by CWS's contention that S.C. Code Ann. § 58-5-240 (Supp. 2004) does not contemplate that disputes between a public utility and an individual customer

³ Three (3) customers stated at the night hearings in this proceeding that they had personally experienced a sewer backup at their premises which caused damage to their properties. Of these customers, only two specifically asserted that the backup was the fault of CWS and both of them stated that compensation was paid by the Company. At least two of these customers stated that the backups occurred more than eight (8) years prior to the hearing, which is five (5) years after the applicable statute of limitations for a property damage claim in the court of common pleas. See S.C. Code Ann. § 15-3-530 (2005). Other customers stated that they were aware of neighbors whom had experienced sewer back-ups.

regarding sewer backups are to be resolved in a rate case proceeding. To the contrary, if a customer is aggrieved by an act or omission of a public utility, the customer has the ability to file a complaint under S. C. Code Ann. § 58-5-270 (1976). The Company is then informed of the factual and legal grounds upon which the complaint is based, can engage in discovery and cross-examination, and thereby offer a defense to the customer's allegations in accordance with our rules of practice and procedure. See 26 S.C. Code Ann. Regs. RR. 103-821 (1976, as amended) and 103-835 (1976). Neither § 58-5-270 nor our related regulations are referenced in our Order No. 2005-101 providing for the "night" hearings in this docket. Nor does Order No. 2005-101 provide that the Commission will address specific customer complaints of things or matters done or failed to be done by CWS. All parties must be placed on notice of the Commission's intent to take action affecting private rights. See *Porter v. S.C. Public Service Comm'n*, 338 S.C. 164, 525 S.E.2d 866 (2000). The Company, just like its customers, is entitled to administrative due process under S.C. Const. art. I, § 22. "The fundamental requirement of due process is the opportunity to be heard at a meaningful time and in a meaningful manner." *S.C. Dep't of Soc. Services v. Holden*, 319 S.C. 72, 78, 459 S.E.2d 846, 849 (1995). Where we to construe § 58-5-240 and § 58-5-270 differently, rate case proceedings could become an avenue for customers to air grievances simply for the purpose of attempting to prejudice a public utility's entitlement to rate relief by avoiding the procedure provided for by statute and our regulations for complaint matters. And, if the Commission were to consider such complaints in the context of rate adjustment proceedings, the affected utility would not have meaningful notice or a meaningful

opportunity to be heard – particularly where, as here, the allegations are first made less than thirty (30) days before a hearing. *Cf.* S.C. Code Ann. § 1-23-320(a) (2005).

Furthermore, even if specific customer testimony regarding sewer backups could be properly considered in the instant proceeding, the Commission agrees with the Company's contention that service quality⁴ is not implicated by the testimony given. As we have already noted, only two of the customers made specific allegations that a sewer back-up was the fault of CWS and both of these customers indicated that compensation had been paid. [See n. 3, *supra.*] Other customer statements regarding sewer backups did not provide detail establishing that an act or omission of the Company was the cause of a backup. This is particularly pertinent since a blockage causing a sewer backup can occur in either the customer's service pipe or the utility's service pipe. [Haas Pre-filed Conditional Rebuttal testimony, Tr. p. 484, ll. 8-11.] See 26 S.C. Code Ann. Regs. R. 103-555 (A) and (B) (Supp. 2004). Moreover, given that the Company serves some 9,700 sewer customers and potentially receives some 1.4 billion gallons of wastewater for treatment on annual basis, we agree with the Company that testimony concerning less than ten occasions of sewer backups over an extended period of time is, quantitatively, *de minimis*. [Haas Pre-filed Conditional Rebuttal testimony, Tr. p. 487 , l. 13 – p. 488, l. 3]. Accordingly, this testimony does not inform the Commission regarding the overall adequacy, and therefore the quality, of the Company's service.

⁴ We address the quality of the Company's service in our discussion of rate of return on rate base below.

Finally, we have consistently held that we do not have jurisdiction to address property damage claims, including claims arising out of sewer backups. *In Re: Bryant and Bryant v. CWS*, Docket No. 97-358-W, Order Nos. 97-1003 and 97-1066, Nov. 24, 1997 and Dec. 29, 1997. *Also see In Re: Million v. Duke Power*, Docket No. 2002-401-E, Order No. 2003-116, March 5, 2003 (Commission lacks jurisdiction to address a tort claim, but may address electric customer allegation of inadequate service and demand for imposition of penalties in a complaint proceeding.) If a customer contends that a utility has acted or failed to act in a manner which causes damage, the proper forum in which to obtain a resolution of such a claim is the courts of this state.

Accordingly, the Company's motion is granted and customer testimony regarding sewer backups is stricken and will not be considered by the Commission in this proceeding.

B. THE STIPULATION BETWEEN CWS AND MIDLANDS

At the hearing, the Company and Midlands submitted a written stipulation and agreement that a reasonable monthly bulk sewer service rate to be charged by CWS for treatment it provides for wastewater flow from Midlands' Vanarsdale subdivision service area is \$15 per single family equivalent. [Tr. p. 71, l. 10 – p. 74, l. 17; Hearing Exhibit No. 7.] Currently, CWS treats 416 single family equivalents for Midlands. [Parnell Pre-filed direct testimony, p. 2, ll. 20-21.] The current monthly rate of \$11 per single family equivalent was approved by this Commission in Docket No. 95-1151-S. ORS stated that it accepted the stipulation and agreement as being in the public interest. [Tr. P. 74, l. 23 – p. 75, l. 6.] DHEC did not take a position on the matter. [Tr. p. 74, ll. 18-19.]

We find that the stipulated rate is reasonable and therefore accept the stipulation and agreement. Under the stipulated rate, Midlands will experience an increase of approximately 36% in bulk treatment charges [Tr. p. 72, ll. 13-21], which is generally consistent with the amount of increase sought for the Company's other sewer customers (both treatment and collection only customers). [Lubertozi Pre-filed direct testimony, Tr. p. 290, l. 26 - p.291, l. 3.] Moreover, this rate is also only 23¢ more per month than a rate proposed by Midlands. [Parnell Pre-filed direct testimony, p. 4, l. 11.] And, the rate established in Docket No. 95-1151-S has been in effect since 1996. [Parnell Pre-filed direct testimony, p. 2, ll. 19-20.] The Company has since that time received approval for an increase in the rates of other customers from which Midlands was excepted. See Order No. 2001-887, August 27, 2001, Docket No. 2000-207-W/S. We find that acceptance of the stipulation is also in the public interest because it reflects a resolution of a disputed issue in a matter within the jurisdiction of the Commission. *Cf.* S.C. Code Ann. § 58-4-50 (A)(9). And, as noted above, there has been no objection by the other parties of record to this stipulation. Accordingly, in giving effect to the stipulation and agreement, the Commission will include \$74,80 for bulk treatment services provided by the Company to Midlands in determining the total revenues in this proceeding.

III. FINDINGS OF FACT AND SUPPORTING EVIDENCE

1. CWS provides water service to approximately 5,800 customers and sewer service to approximately 10,000 customers in portions of Aiken, Beaufort, Charleston, Dorchester, Georgetown, Lexington, Orangeburg, Richland, Sumter, Williamsburg and York counties. As a

public utility, its operations are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §§ 58-5-10 *et seq.* (1976 & Supp. 2004).

The evidence supporting this finding is contained in the Company's application, the testimony of its witnesses Haas [Haas Pre-filed Direct testimony, Tr. p.322, ll. 18-20] and Lubertozi [Lubertozi Pre-filed Direct testimony, Tr. p. 288, ll. 12-17] and in the testimony of ORS witness Hipp [Hipp Pre-filed Direct testimony, Tr. p. 415 ll. 8-21.]

2. The appropriate test year for purposes of this proceeding is the twelve month period ending June 30, 2004.

The evidence supporting this finding is contained in the Company's application, the testimony of its witness Lubertozi [Lubertozi Pre-filed Direct testimony, Tr. p. 289, ll. 5-7], and the ORS Audit Department Report sponsored by ORS witness Scott [Scott Pre-filed Revised Direct testimony, Tr. p. 434, ll. 4-10 and 18; Hearing Exhibit No. 19 at 2, ¶ 3], which reflects that CWS proposed a test year ending June 30, 2004 and that ORS accepted that as an appropriate test year. No other party objected to the proposed test year.

A fundamental principle of the ratemaking process is the establishment of a test year period. In *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826 (1996), the Supreme Court observed that "[t]he 'test year' concept is very important in the rate-setting process. In order to determine what a utility's expenses and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues." *Id.*, 478 S.E.2d 828, n. 1. The test year is established to provide a basis for making the most accurate forecast of the utility's rate

base, reserves, and expenses in the near future when the prescribed rates are in effect. *Porter v. South Carolina Pub. Serv. Comm'n*, 328 S.C. 222, 493 S.E.2d 92 (1997). The historical test year may be used as long as adjustments are made for any known and measurable out-of-period changes in expenses, revenues, and investments. *Id.* Accordingly, the Commission adopts the test year proposed by the Company and will make adjustments for any known and measurable changes outside the test year.

3. The Commission will use rate of return on rate base as a guide in determining just and reasonable rates.

The evidence supporting this finding is contained in the Company's application and the testimony of its witness Lubertozzi. [Lubertozzi Direct Pre-filed testimony, Tr. p. 296, l. 25 – p. 297, l. 5.] Additionally, no other party of record proposed an alternative method for determining just and reasonable rates and the testimony of ORS's witnesses Scott and Johnson contemplate that return on rate base will be the methodology employed.

The Commission has wide latitude in selecting an appropriate rate-setting methodology. *Heater of Seabrook, supra*, 478 S.E.2d at 830. Even though S.C. Code Ann. § 58-5-240(H) (Supp. 2004) requires the Commission to specify an operating margin in all water and sewer cases, the Commission is not precluded by that statute from employing the return on rate base approach to ratemaking. *Id.* Operating margin "is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary debt and equity capital that a large utility needs for sound operation." *Id.* In the Company's last rate case, we employed the return on rate base methodology. The Company's unadjusted rate base, according

to its application, is \$15,639, 930. Given the foregoing, and the uncontradicted testimony that the Company has a need to earn a fair and reasonable return on its investment, the Commission finds that the return on rate base methodology is the appropriate methodology to use in this case.

4. The determination of return on rate base requires consideration of three components, namely: capital structure, cost of equity (or return on equity) and the cost of debt.

The evidence supporting this finding is contained in the testimony of the Company's and ORS's expert witnesses on cost of capital. [Ahern Direct Pre-filed testimony, Tr. p. 136, ll. 3-9; Johnson Direct Pre-filed testimony, Tr. p. 228, l. 19 - p. 229, l. 9.]

5. In determining the Company's appropriate return on rate base, the correct capital structure and cost of debt is that of CWS's parent, Utilities, Inc., at December 31, 2003. Accordingly, for purposes of this proceeding, the correct capital structure 59.23% (debt) and 40.07% (common equity) and the correct cost of debt is 7.28%.

The evidence supporting this finding is contained in the testimonies of Company witness Ahern. [Ahern Direct Pre-filed testimony, Tr. p. 136, ll. 5-8] and ORS witnesses Scott [Scott Revised Direct Pre-filed testimony, Tr. p. 434, ll. 6-10, Hearing Exhibit No. 19, pp. 4-5 and p. 22 and Johnson [Johnson Direct Pre-filed testimony, Tr. p. 228, l. 19 - p. 229, l. 17.] Use of the cost of debt of Utilities, Inc., verified by the ORS audit staff, is appropriate as CWS obtains all of its external financing from its parent, which determines how much income CWS can retain. This approach is also consistent with the analysis we employed in the Company's last rate case. [Id.]

6. A fair return on equity for CWS is 11.50%.

The evidence supporting this finding is contained in the testimonies of Company witness Ahern and ORS witness Johnson. As noted by witness Ahern, under the standards enunciated in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Bluefield Water Works Improvement Co. v. Public Service Comm'n*, 262 U.S. 679 (1922), a utility is entitled to an opportunity to earn a fair rate of return. [Ahern Direct Pref-filed testimony, Tr. p. 138, ll. 1-4.] The rate of return on common equity is a key figure used in calculating a utility's overall rate of return. *Porter v. South Carolina Public Service Commission*, 333 S.C. 12, 507 S.E.2d 328 (1998).

To determine the cost of equity, both Ahern and Johnson employed the Comparable Earnings Model ("CEM")⁵ and Discounted Cash Flow ("DCF").⁶ In addition, Ahern also utilized the Capital Asset Pricing Model ("CAPM") and the Risk Premium Model ("RPM"). Both DCF and CAPM are market-based approaches relying upon transactions in the securities markets and estimates of investor expectations. Charles F. Phillips, Jr., *The Regulation of Public Utilities* (1993) at 394.

Ahern testified that she used the results from the application of the DCF approach, RPM, CAPM, and the CEM to determine a common equity cost rate because no single cost of equity model is so inherently precise that it can be relied upon solely to the exclusion of other

⁵Johnson used the term "Comparable Earning Analysis" when referring to the CEM approach. For ease of reference, the Commission will refer to his "Comparable Earning Analysis" as CEM.

theoretically sound models. Moreover, because all four models are based upon the Efficient Market Hypothesis (EMH) and have application problems associated with them, the EMH and financial literature requires the assumption that investors rely upon multiple cost of common equity models. [Ahern Pre-filed Direct testimony, Tr. p. 150, l. 8 - p. 154, l. 25; p. 161, ll. 20-29; p. 189, l. 20 - p. 190, l. 6.]

Ahern assessed the market-based cost rates of similar risk companies, i.e. proxy groups, for insight into a recommended common equity cost rate for CWS. [Ahern Pre-filed Direct testimony, Tr. p. 140, ll. 5-6.] The proxy groups were used by Ahern because the Company's common stock is not publicly traded, and, therefore, CWS's market-based common equity cost rates cannot be determined directly. [Ahern Pre-filed Direct testimony, Tr. p. 137, l. 26 - p. 138, l. 10; p. 143, l. 15 - p. 145, l. 12.] Therefore, Ahern used two proxy groups of water companies whose common stocks were actively traded for insight into an appropriate common equity cost rate applicable to CWS. [Id.] The two proxy groups consist of six and three water companies, respectively. [Ahern Pre-filed Direct testimony, Tr. p. 144, Table 3.] Ahern selected the proxy group of six AUS Utility Reports water companies because (1) they were included in the Water Company Group of AUS Utility Reports (March 2005), (2) they have Value Line or Thomson FN/First Call Consensus projected growth rates in earnings per share, and (3) have more than 70% of their 2003 operating revenues derived from water and sewer operations. [Ahern Prefiled Direct testimony, Tr. p. 148, ll. 2-9.] The three Value Line water companies were chosen

⁶Johnson used the term "market approach" when referring to his analysis which included DCF. For ease of reference, the Commission will refer to his "market approach" as DCF.

because they are included in the Water Utility Group of Value Line (Standard Edition) Water Utility Industry Group. [Ahern Prefiled Direct testimony, p. 149, ll. 5-10.]

Ahern's DCF analysis yields cost rates for the proxy group of six AUS Utility Reports companies of 10.60% and for the proxy group of three Value Line water companies of 10.80%. [Ahern Prefiled Direct testimony, Tr. p. 165, ll. 5-10.] The results of the RPM analysis produced common equity cost rates of 10.60% for the six AUS Utility Reports water companies and 10.80% for the proxy group of three Value Line water companies. [Ahern Prefiled Direct testimony, Tr. p. 174, ll. 16-20.] The CEM produces common equity cost rate results of 14.50% for the proxy group of six AUS Utility Report water companies and 14.40% for the proxy group of three Value Line water companies. [Ahern Prefiled Direct testimony, Tr. p. 189, ll. 9-11.] Finally, the traditional CAPM cost rate is 9.90% for the proxy group of six AUS Utility Reports water companies and 10.20% for the three Value Line water companies. The empirical CAPM cost rate is 10.40% for the proxy group of six AUS Utility Reports water companies and 10.60% for the proxy group of three Value Line water companies. The CAPM cost rate for the proxy group of six AUS Utility Reports water companies is 10.20% and for the three Value Line water companies is 10.40% based upon the traditional and empirical CAPM results. [Ahern Prefiled Direct testimony, Tr. p. 180, l. 20 – p. 181, l. 6.] The average cost of common equity for the proxy group of six AUS Utility Reports water companies is 10.9% and the average for the proxy group of three Value Line water companies is 11.0%. Ahern reviewed the results of the application of the four different cost of common equity models and then adjusted them upward to reflect CWS's greater risk compared to the proxy groups by adding an investment risk

adjustment of .50% (50 basis points) to the average cost of equity of both proxy groups. This yielded Ahern's recommended range of common equity cost rates is 11.40% for the proxy group of six AUS Utility Reports water companies and 11.50% for the proxy group of three Value Line water companies. [Ahern Pre-filed Direct testimony, Tr. p. 137, ll. 1-26; p. 189, ll. 14-19.] In Ahern's opinion, the investment risk adjustment is necessary because CWS is a more risky investment than the average proxy group company due to CWS's small size compared to the two proxy groups, whether measured by book capitalization or the market capitalization of common equity. [Ahern Direct Prefiled testimony, Tr. p. 191, l. 32 - p. 192, l. 4.] Ahern asserted that the loss of revenue from a few larger customers would have a greater effect on a small company than on a much larger company with a larger customer base. [Ahern Direct Pre-filed testimony, Tr. p. 143, l. 24 - p.144, l. 2.] Ahern then opined that, based upon the slightly greater financial risk of CWS *vis-a-vis* the nine proxy group companies [Ahern Direct Pre-filed Direct testimony, Tr. p. 147, ll. 10-16], CWS should be authorized a return on common equity at the higher end of her range, which is 11.50%. [Ahern Direct Pre-filed Direct testimony, Tr. p. 193, ll. 19-20.]

We accept the conclusions of witness Ahern and adopt her recommended return on equity of 11.50%. In so doing, we necessarily reject the analysis ORS witness Johnson which gives rise to his recommended ranges of return on equity of 9.5% to 10.8% using DCF and 10.1% to 11.1% using CEM. [Johnson Direct Pre-filed testimony, Tr. p. 254, ll. 11-13.] Our reasons for doing so are several.

First, we agree with witness Ahern that the approach used by Dr. Johnson to estimate common equity cost ranges improperly utilizes only historical data. [Ahern Rebuttal Pre-filed

testimony, Tr. p. 196, l. 16 - p. 197, l. 17.] In his surrebuttal, Dr. Johnson effectively concedes that it is inappropriate to utilize only historical data by acknowledging that “cost of capital is a forward looking concept” and asserting that he did not rely solely on historical data. [Johnson Surrebuttal Pre-filed testimony, Tr. p. 259, l. 22- p. 260, l. 2.] Even absent Dr. Johnson’s implicit acknowledgment that reliance upon only historical data is inappropriate, we would agree with the assertion in this regard by Company witness Ahern. She correctly notes that the approach to determining the cost of common equity under the rate of return on rate base methodology accepted by the Commission in the Company’s last rate case employed an analysis of historical data, current market data, and projected data. [Ahern Pre-filed Rebuttal testimony, Tr. p. 199, ll. 14-22.] There is no evidence of record supporting a departure from that analysis in this case – particularly given Dr. Johnson’s implicit acknowledgment that historic data alone is insufficient. Although we are not bound to utilize the same analysis in this rate case, we cannot arbitrarily depart from our prior precedent. *See 330 Concord Street Neighborhood Ass’n v. Campsen*, 309 S.C. 514, 424 S.E.2d 538 (Ct. App.1992). Furthermore, it would be inappropriate for the Commission to limit itself to a consideration of historical data where the analytical tool for determining a return on equity is based in part upon the future performance of a stock or market. *Cf. Hamm v. Southern Bell*, 302 S.C. 132, 394 S.E.2d 311 (1990) (holding that the Commission should not be required to consider only historical data in determining rates because it may “be entirely inappropriate for the PSC to refuse to consider a future event.”) And, given the prospective nature of ratemaking (*see Parker v. S.C. Publ. Serv. Comm’n*, 288 S.C. 304, 342 S.E.2d 403 91986)), which involves the forecasting of utility rate base, reserves and expenses to

estimate rates to be used in a future period (*see Hamm v. Public Serv. Comm'n, supra*, 422 S.E.2d at 114), reliance on historic data alone would not be proper.

Secondly, there is insufficient evidence of record to support the opinion advanced by Dr. Johnson. He effectively concedes that he did not utilize any data other than historical data since he acknowledges that he “used judgment in **interpreting the historical data**, taking into consideration **fluctuations in that data, trends in that data**, and the **likely future course of each specific data set.**” [Johnson Surrebuttal Prefiled testimony, Tr. p. 260, ll. 2-4 (emphasis supplied).] Quite clearly, Dr. Johnson limited his **data** analysis to the historic data. Dr. Johnson’s “careful[] consider[ation]” of “investors’ expectations about future market conditions, as well as future growth in earnings, dividends and book value” in developing his DCF based market approach [Id., ll. 4-7] references no data or facts upon which Dr. Johnson relied to ascertain such “investors expectations” for purposes of determining his recommended rate. To the contrary, although Dr. Johnson states that he intentionally eschews “a strictly mechanical process” which would not take into account “available evidence regarding investors’ moods and expectations nor subtle nuances such as the sustainability of particular growth rates (whether achieved or projected)” [Id., ll. 9-15] he does not cite to any data or other facts constituting this “available evidence” or supporting these “subtle nuances” upon which he relied in formulating his opinion.⁷ The Commission simply cannot accept expert opinion testimony unless there is an

⁷ The record reflects that the dividend yield used in Dr. Johnson’s DCF analysis is not based upon facts other than the historic data referenced in his testimony. Referring to Schedule 4 to his direct testimony, Dr. Johnson described variances in the average dividend/price ratio, or yield, for the ten proxy companies he selected for the period 1995 -2003 and shorter periods of

evidentiary showing of the facts upon which the opinion is based as such an opinion does not constitute substantial evidence. *See Hamm v. Southern Bell Telephone & Telegraph Co.*, 302 S.C. 132, 394 S.E.2d 311 (1990) *cert. denied*, 498 U.S. 1109, 111 S.Ct. 1018, 112 L.Ed.2d 1099 (1991), *citing*, *Parker v. S.C. Public Service Comm'n*, 281 S.C. 215, 314 S.E.2d 597 (1984). Since, Dr. Johnson derived his opinion regarding investors' expectations based upon matter other than the historical data reflected in his testimony, such matter is not contained in the record of evidence in this case and we are therefore compelled to disregard his opinion.

Thirdly, we agree with Company witness Ahern that the utilization of multiple approaches to determining an appropriate return on equity is best. As Ahern correctly notes, multiple approaches to determining return on equity were utilized in the Company's last rate

time encompassed therein. [Johnson Direct Pre-filed testimony, Tr. p. 249, ll. 6-11]. He then stated that "[a]fter evaluating **this data**, I selected a dividend yield of 3.0% – 3.3% for my DCF analysis." [Id., ll. 11-12 (emphasis supplied).] And, although Dr. Johnson contends that he "did not simply adopt the historic rate of growth" and therefore "depart[ed] from the historic data . . . due in part to investors' future expectations" [Johnson Surrebuttal Pre-filed testimony, Tr. p. 260, ll. 21-25], he does not cite to or describe any data, studies or facts upon which he relied to arrive at his decision to utilize a 5.5% to 6.5% growth rate range for dividends, earnings and book value in his DCF analysis. [Id., Tr. p. 260, l. 4 - p. 261, l. 7.] Rather, a close examination of Dr. Johnson's analysis in this regard reveals that he selected the 5.5% - 6.5% range because it "is generally consistent with the average growth in book value that was by experienced by these 10 [proxy] water companies from 1995 through 2003" [Johnson Direct Pre-filed testimony, Tr. p. 252, ll. 2-4], "falls between the 9.7% book value growth rate experienced during 2001-2003 and the 1.4% growth rate experienced during 2002-2002", "is somewhat lower than the average rate of growth in book value during 1997-2003 of 7.1%", "but . . . encompasses the corresponding growth rates during 1997-2002 (6.3%) and 1996-2002 (6.2%)." [Id., ll. 11-15.] And, consistent with Mrs. Ahern's assertion, there is also nothing in Dr. Johnson's testimony demonstrating a factual basis upon which he relied to arrive at his opinion using the CEM methodology other than historical data. [Ahern Rebuttal Pre-filed testimony, Tr. p. 200, l. 20 - p. 201, l. 6; p. 201, l. 22 - p. 202, l. 10.] This, too, is essentially conceded by Dr. Johnson's surrebuttal testimony

case, including DCF, CAPM, and RPM. [Ahern Rebuttal Pre-filed testimony, Tr. p. 199, ll. 18-22.] Of these three, Dr. Johnson only utilized the DCF approach in developing his opinion. By contrast, Ahern employed all three of these approaches plus the CEM. As we have already noted, we are not bound to follow our prior order in this regard. *330 Concord Neighborhood Ass'n, supra*. However, there is no evidence of record upon which this Commission may rely to justify departing from its recognition of DCF, CAPM and RPM as useful approaches in determining the Company's rate of return on equity. Given that Ahern's opinion relies upon the application of each of these approaches, we conclude that her opinion is entitled to the greater weight in our determination of the Company's proper return on equity. *See S.C. Cable Television Ass'n v. Southern Bell*, 308 S.C. 216, 417 S.E.2d 586 (1992) (holding that the Commission is entitled to give less weight to expert testimony based upon "conjectures and incomplete information.").

We therefore adopt Ahern's recommendation and set CWS's return on equity at 11.50% for purposes of this proceeding.⁸

7. The Company provides adequate water and wastewater service to its customers and there is no basis to deny or delay rate relief due to a poor "quality of service".

which simply references his consideration of investor expectations in the context of his DCF analysis. [Johnson Surrebuttal Pre-filed testimony, Tr. p. 264, ll. 11-14.]

⁸ Both ORS witnesses Johnson and Hipp testified that the Commission could consider the quality of the Company's service in determining an appropriate return on equity and suggested that setting the rate of return at the lower end of a recommended range is an appropriate method of giving effect to our findings in that regard. Because we find that the Company provides adequate service, it is unnecessary for us to address this contention.

The evidence supporting this finding is contained in the testimony of Company witness Haas. [Haas Direct Pre-filed testimony, Tr. p. 322, l. 8 – p. 325, l. 23.] The evidence supporting this finding is also found in Hearing Exhibit No. 17 reflecting the conclusion of ORS that the Company’s water and wastewater facilities provide adequate service and comply with all DHEC rules, regulations and consent orders. [Hearing Exh. No. 17, p. 1.] The Commission makes this finding taking into account the statements made by customers at the four night hearings in this proceeding in which general complaints were aired regarding sewer plant odor, lack of responsiveness to customer inquiries and complaints, customer service representative attitudes and general objection to an increase in rates.

With respect to sewer odor, we note that the Company is required by our regulations “to provide sewerage service **insofar as practicable** free from objectionable odors.” 26 S.C. Code Ann. Regs. R. 103-570 (1976) (emphasis supplied). Thus, the Commission recognizes that the presence of odor is not in and of itself indicative of inadequate service. Moreover, sensitivity to sewer odor is subjective in nature and largely dependent upon exogenous factors, including plant location, weather, customer activity in the area, and plant type. [Haas Rebuttal Pre-filed testimony, Tr. p. 465, l. 13 - p. 466, l. 12]. The conflicting testimony of the various customers and ORS witness Morgan on this point bears out our finding in this regard. [Id., Tr. p. 465, l. 27 – p. 466, l. 4; Hearing Exh. No. 16, p. 3, n. 2.] We further note that the Company had already begun to act to address the presence of odor at two (2) of the three (3) treatment plants about which customers complained – Friarsgate and Watergate– prior to the night hearings in this docket. [Haas Direct Pre-filed testimony, Tr. p. 325, ll. 10-23; Haas Rebuttal Pre-filed

testimony, Tr. p. 466, l. 25 - p. 467, l. 17; Hearing Exh. No. 16, p. 3, n. 2; p. 15, “Comments”).]

With respect to odor complaints at the Company’s Kings Grant treatment facility, the Company has purchased additional equipment in an effort to better abate odor. [Haas Rebuttal Pre-filed testimony, Tr. p. 467, ll. 18-22.]

The Company’s reported lack of responsiveness to customer inquiries and complaints, although important, is not a basis for the Commission to determine that the Company’s quality of service is inadequate. While the Commission strongly encourages the Company, and all jurisdictional utilities, to promptly respond to customer inquiries and complaints, we cannot conclude on the record before us that the Company has neglected to do so to the point that its service may be characterized as inadequate. According to ORS witness Hipp, only eighteen (18) service and billing complaints were received by the ORS Consumer Services Department during the test year. [Hearing Exh. No. 17, p. 1.] Ms. Hipp further testified that the Company maintains a customized computer database which captures all customer complaints and reflects the resolution of same. [Hipp Direct Pre-filed testimony, Tr. p. 416, ll. 7-17.] Under examination by the Commission, Ms. Hipp further stated that she was impressed by the Company’s complaint tracking system. [Tr. p. 428, l. 7 – p. 429, l. 16.] In short, the Company’s complaint tracking system fully complies with our regulations. See S.C. Code Ann. Regs. RR. 103-516 and 103-716 (Supp. 2004). Ms. Hipp further found that the Company employs an adequate telephone system to accept customer complaints and inquiries. [Hearing Exh. No. 17, p. 3, item no. 12.] Given that the Company has approximately 16,000 customers and only 18 customer complaints were unresolved to the point that customers contacted ORS for assistance

during the test year, we cannot find that the Company is unresponsive to customer complaints or inquiries.

Several customers stated a concern over the attitude of the Company's customer service representatives, with many employing the descriptor "arrogant." While the Commission has no regulation which mandates that employees of a jurisdictional utility adopt a specific tone, be of a specific temperament or display a specific attitude when dealing with customers, the Commission expects that public utility employees – including those of CWS – will be civil in their dealings with customers. Likewise, the Commission expects customers – including those of the Company – to also comport themselves in a civil manner when dealing with utility employees.

Finally, the Commission understands that customers do not generally desire that their utility rates be increased. We cannot, however, consistent with our duty to set just and reasonable rates, base our decision upon customer desire to avoid rate increases.⁹ Rather, we are

⁹ Most vociferous of the customers asserting that rate relief should be denied were those served by the Company's River Hills system in York County. The Commission has previously rejected a specific complaint seeking a reduction in rates for these customers and, in the last rate case, eliminated a differential in rates among the Company's customers which favored River Hills customers. See Order Nos. 1999-245, Docket No. 97-464-W/S, April 2, 1999, and 2001-887, Docket No. 200-207W/S. The rate levels for River Hills are largely a function of the bulk service rates imposed by York County and the customers in River Hills sought the interconnection with York County knowing that higher rate levels would result. See Order No. 96-590, Docket No. 96-040-W/S, August 26, 1996. [Haas Rebuttal Pre-filed testimony, Tr. p. 478, l. 10- p. 479, l. 2.] More than half of the current bill for the average customer in River Hills is paid to York County and not the Company. [Lubertozzi Rebuttal Pre-filed testimony, Tr. p. 507, l. 22 - p. 508, l. 12; Hearing Exh. No. 21.] Nothing in the record of evidence before us would justify our departing from our prior resolution of the complaint of River Hills customers concerning rate levels and we decline to do so. *330 Concord Street Neighborhood Ass'n, supra.*

obligated to balance the interests of the customer with the utility's right to earn a fair return. *South Carolina Cable Television Ass'n v. Public Service Comm'n*, 313 S.C. 48, 437 S.E.2d 38 (1993). Similarly, we cannot base our decision on specific customer complaints – aired to us in night hearings and not in the context of the statutory and regulatory procedures established to address specific complaints – under the rubric that such complaints reflect the Company's "quality of service." The Commission is entitled to impose reasonable requirements on jurisdictional utilities to ensure that adequate and proper service is rendered to their customers. *Patton v. S.C. Public Service Comm'n*, 280 S.C. 288, 312 S.E.2d 257 (1984). Accordingly, we may delay implementation of a rate adjustment where inadequate facilities result in service that is not adequate and proper. *Id.* Because we have concluded that the Company provides adequate and proper service, however, there is no basis upon which we may find that Company's quality of service justifies a delay in implementation of rate relief that is otherwise justified. Moreover, making a determination of overall quality of service based upon such specific customer complaints implicates the Company's due process rights to the point that we decline to do so.

8. Using the capital structure of Utilities, Inc. consisting of 59.23% debt and 40.77% common equity, a cost of debt of 7.28%, and a cost of equity of 11.50%, we conclude that an appropriate overall rate of return on rate base of 9.00% is appropriate and should be authorized for CWS. The evidence supporting this conclusion is found in the testimony of Company witness Ahern. [Ahern Direct Pre-filed testimony, Tr. p. 137, ll. 1-11; p. 193, ll. 9-12.] The following table indicates the capital structure of the Company, the cost of debt, the cost of equity as approved in this Order, and the resulting rate of return on rate base:

TABLE A

	RATIO	EMBEDDED COST	OVERALL COST
Long-term Debt	59.23%	7.28%	4.31%
Common Equity	<u>40.77%</u>	11.50%	<u>4.69%</u>
TOTAL	<u>100.00%</u>		<u>9.00%</u>

9. By its Application, CWS is seeking an increase in its rates and charges for water and sewer service which results in \$1,801,488 of additional revenues to CWS.

The evidence for the finding concerning the amount of the requested rate increase is contained in the Application filed by CWS and in the testimony and exhibits of ORS witness Scott. The Application of CWS indicates that it is seeking additional revenues of \$180,854 from water operations and additional revenues of \$1,634,674 from sewer operations which, after adjustment for uncollectible accounts, totals \$1,801,488. [Application, Exhibit B, Schedule B, p. 1 of 4.] Additionally, ORS witness Scott testified that under the rates proposed in the Application CWS would see an increase in revenues of \$1,801,488. [Scott Revised Direct Prefiled testimony, p. 436, ll. 3-4, Hearing Exh. No. 19, p. 6.] No party presented any evidence that the requested increase does not amount to \$1,801,488. Therefore, the Commission finds that CWS is seeking an increase in its revenues of \$1,801,488.

10. The appropriate operating revenues for CWS for the test year under present rates and after accounting and pro forma adjustments are \$5,674,555.

The evidence supporting this finding is in the testimony of Company witness Lubertozzi and ORS witness Scott. The application of CWS, shows per book test year total operating revenues of \$5,644,689. [Application, Exhibit B, Schedule B, p. 1 of 4.] This amount included “Uncollectibles” of \$42,869 and miscellaneous revenues of \$106,827. [Id.] ORS adjusted test year operating revenues by \$29,865 based upon a bill frequency analysis it performed in connection with its audit, with water being adjusted by \$15,618 and sewer being adjusted by \$14,247. [Scott Pre-filed Revised Direct testimony, p. 436, ll. 13-18; Hearing Exh. No 19, p. 6, p. 9.] ORS also included “Uncollectibles” of \$42,689 in the per books test year figures. [Id.] Thus, ORS computed per book test year total operating revenues of \$5,674,555. Company witness Lubertozzi agreed with the adjustment to operating revenues proposed by ORS. [Tr. p. 490, ll. 19-22; Tr. p. 491, ll. 10-14.] No other party presented any evidence pertaining to per book test year total operating revenues. Therefore, the only evidence before the Commission on per book total operating revenues is the \$5,674,555 and the Commission finds that to be the appropriate per book test year total operating revenues.

11. The appropriate operating expenses for CWS for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of test-year occurrences are \$5,276,647.

The evidence supporting this finding is contained in the Company’s application and in the testimonies of Company witness Lubertozzi and ORS witness Scott. ORS offered certain adjustments to the Company’s proposed operating expenses for the test year which the Company accepted. [Scott Pre-filed Revised Direct testimony, Tr. p. 436, l. 19 - p. 443, l. 4, Tr. p. 447, l.

16 – p. 448, l. 4; Lubertozzi Rebuttal Pre-filed testimony, Tr. p. 490, ll. 19-22; p. 491, ll. 10-14.]

No other party of record offered testimony pertaining to the Company's expenses or proposed adjustments thereto. These operating expenses, and the adjustments agreed to by the Company and ORS which affect operating expenses, are as follows:

(A) Operators' Salaries:

(1) Position of CWS: Initially, CWS proposed an adjustment to salaries of \$236,761, to be annualized as of June 30, 2004, to reflect salary and wages for six new operators and a manager to meet DHEC requirements for daily monitoring of water systems. At hearing, CWS agreed to the position of ORS on this adjustment, which proposed a total adjustment of \$141,365.

(2) Position of ORS: ORS adjusted to reflect only the four new operators hired and verified to CWS's payroll records and did not reflect the remaining three positions since they were not filled and therefore are not known and measureable. Although it accepted CWS's capitalization ratio, ORS reduced the amount of labor capitalized by \$3,969 to account for time spent by operators on capital projects. This resulted in a reduction to CWS's proposed adjustment of \$137,376, leaving a total adjustment of \$141,365 to salaries and wages.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(B) Consumer Price Index Adjustments

(1) Position of CWS: The Company initially proposed to increase certain maintenance and general expenses by 5.74% to reflect inflation utilizing the Consumer Price

Index ("CPI") for Water and Sewerage Maintenance developed by the United States Department of Labor Bureau of Labor Statistics, the effect of which would have been to add \$84,311 to test year expenses. At hearing, CWS agreed with the position of ORS to disallow this adjustment.

(2) Position of ORS: In its Adjustment items numbers 3-9 and 13-17, ORS disagreed with the Company's proposal to adjust expenses using the CPI on the grounds that the adjustments would be made based upon economic forecasts which are not known and measureable. Accordingly, the related (\$83,688) adjustment to operating expense charged to plant should also be rejected.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the agreement of the Company and ORS that this adjustment should not be made.

(C) Transportation Expenses

(1) Position of CWS: The Company initially proposed to increase this expense by \$16,434 to reflect seven new vehicles (for the seven new employees described in the Salary and Wage adjustment discussion above), the purchase of which was documented. At hearing, CWS agreed with the position of ORS to disallow three of the seven new vehicles proposed for inclusion under this adjustment leaving a total adjustment of \$14,208.

(2) Position of ORS: ORS proposed that this adjustment be allowed only to the extent that the employees who would utilize the vehicles had been hired. This results in a lower adjustment of \$14,208.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(D) Deferred Expenses:

(1) Position of CWS: CWS did not propose an adjustment to this item but agreed with the ORS proposal at hearing.

(2) Position of ORS: ORS proposed an adjustment of \$4,960 for Deferred Charges. ORS proposed to remove from Deferred Expenses a recurring, anticipated expense for tank maintenance for water operations of (\$13,057), but to include current expenses in the test year for tank maintenance of \$29,902. ORS also proposed to defer hurricane and storm expenses of \$17,828, resulting in a net deferral for this expense category of (\$11,885). According to ORS, this adjustment is consistent with treatment of deferred expenses in the Company's last rate case.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS. In *Porter v. South Carolina Public Service Commission*, 328 S.C. 222, 493 S.E.2d 92 (1997), the Supreme Court of South Carolina reviewed our decision in the Company's last rate case and held that a deferred expense is extraordinary in nature, i.e., one which is neither recurring nor unanticipated. Accordingly, routine expenses required at regular intervals do not qualify as extraordinary. The Commission adopts the adjustment proposed by ORS as it is based upon *Porter v. South Carolina Public Service Commission*, *supra*.

(E) Office Salaries:

(1) Position of CWS: The Company proposed an adjustment of \$35,479 to General & Administrative Expenses to annualize office salaries. At hearing, however, the Company agreed with the proposal of ORS for a smaller adjustment.

(2) Position of ORS: ORS also proposed to annualize Office Salaries. Staff annualized the year-end payroll totaling \$304,053. From this amount, Staff subtracted the per book amount of \$290,536 for a net adjustment of \$13,517.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(F) Rate Case Expenses:

(1) Position of CWS: CWS proposed an adjustment for estimated rate case expenses of \$123,432, amortized over three years, less per book fully amortized rate case expense for an adjustment of (\$60,482). CWS updated its rate case expenses prior to hearing through documentation supplied to ORS and seeks recovery of rate case expenses of \$171,902. These included legal and consulting fees, direct time spent by corporate office staff, travel and associated expenses. CWS proposed to amortize rate case expenses over a three year period. At hearing, CWS agreed with the ORS position on rate case expenses.

(2) Position of ORS: ORS accepts the Company's updated rate case expenses totaling \$171,902 and the proposed amortization period of three years, which results in an adjustment of \$57,301. ORS subtracted the per book fully amortized adjustment of \$101,626, resulting in an adjustment of \$44,325. ORS also included an additional \$9,000 related to expenses to update the

Company's performance bond, consistent with the testimony of ORS witness Hipp and Company witness Lubertozzi, yielding a total adjustment of (\$35,325).

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(G) Pension and Other Benefits:

(1) Position of CWS: CWS proposed to annualize pension and other benefits associated with the wage adjustment for operators and office employees and proposed an adjustment of \$68,859. At hearing, CWS agreed with the ORS position on this adjustment.

(2) Position of ORS: ORS agreed that an adjustment was appropriate in this regard, but did not include part-time employee wages in its computation since they do not receive benefits. The ORS adjustment was \$45,435, which yields a test year pension and other benefits total, as adjusted, of \$251,971.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(H) Employee Bonuses:

(1) Position of CWS: CWS did not propose an adjustment to this item, but included in salaries and wages office employee bonuses of \$8,225 and corporate employee bonuses of \$14,462. At hearing, CWS agreed with the ORS adjustment to this expense item.

(2) Position of ORS: ORS proposed to remove bonuses for employees from operating expenses as it considers bonuses to be the responsibility of the stockholders, not the ratepayers. The total of the ORS adjustment is (\$22,687).

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(I) Out of Period Expenses

(1) Position of CWS: CWS did not propose an adjustment for out of period expenses, but agreed at hearing with the ORS proposal for such an adjustment.

(2) Position of ORS: ORS proposed that test year expenses be adjusted to remove out of period expenses for property insurance (\$31,649), sewer rodding and maintenance and repairs (\$14,415) and non-allowable DHEC fines and entertainment expenses (\$22,850) for a total adjustment of (\$68,914).

(3) Decision of the Commission: Upon consideration of these expense items, the Commission adopts the adjustment agreed to by the Company and ORS.

(J) Depreciation Expense Adjustment:

(1) Position of CWS: CWS proposed an adjustment of \$79,436 to annualize Depreciation Expense. At hearing, CWS agreed with the position of ORS on depreciation expense adjustment.

(2) Position of ORS: ORS proposed to annualize Depreciation Expense with an adjustment of \$26,705. ORS's proposed adjustment included gross plant of \$37,107,047 plus verified plant to date of \$696,396 less Organization Expense, Land, Vehicles, Plant Acquisition Adjustment, and Advances in Aid for a net plant of \$36,588,217. ORS included depreciation expense associated with the Water Service Corporation rate base and for the amortization of excess book value. ORS made separate adjustments for the depreciation expense associated with

the removal of wells. ORS used a depreciation rate of 1.50% for plant other than vehicles and a 25.00% depreciation rate for vehicles per the recommendation of the ORS Water/Wastewater Department. ORS's total computed Depreciation amounted to \$616,647, less the per book amount of \$589,942, resulting in a net adjustment of \$26,705.

(3) Decision of the Commission: Upon consideration of these expense items, the Commission adopts the adjustment agreed to by the Company and ORS.

(K) Amortization of Contributions in Aid of Construction (CIAC):

(1) Position of CWS: CWS proposed adjust the amortization for CIACs using a 1.50% depreciation rate. The total of CWS's proposed adjustment in this regard was \$15,286. At hearing, CWS agreed with the ORS position on this adjustment.

(2) Position of ORS: The ORS proposes to utilize the same depreciation rate as CWS, but submits an alternative calculation for this adjustment. Utilizing a gross per books CIAC amount of \$17,122,470, ORS calculates an amortization amount of (\$256, 837). Subtracting the per book amount of (\$252,590) yields a total adjustment of (\$4,247).

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(L) Retired Wells River Hills, I-20, Watergate and Westside Terrace:

(1) Position of CWS: CWS included depreciation expense associated with wells which are no longer used and useful. At hearing, CWS agreed with the position of ORS on this matter.

(2) Position of ORS: ORS proposed an adjustment of (\$7,568) to remove depreciation expense for wells for the River Hills, I-20, Watergate and Westside Terrace water systems per the terms of the Commission's order in the last rate case.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(M) Extraordinary Retirement of Wells

(1) Position of CWS: CWS proposed to include \$29,924 in expenses as approved in the Company's last rate case.

(2) Position of ORS: ORS agreed with the Company's proposed adjustment.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS as being consistent with our last rate case order for CWS.

(N) Property Taxes

(1) Position of CWS: CWS included \$8,599 in property taxes for the retired wells in River Hills, I-20, Watergate and Westside Terrace and improperly recorded \$264,492 in property taxes actually paid in the test year. At hearing, CWS agreed with ORS's proposed adjustment to correct these expense items.

(2) Position of ORS: ORS proposed an adjustment of (\$8,599) to delete taxes on the retired wells and \$264,492 to include test year property taxes that were not properly recorded.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustments agreed to by the Company and ORS.

(O) Other Taxes:

(1) Position of CWS: CWS did not proposed an adjustment for Utility/Commission taxes and Gross Receipts taxes associated with as adjusted revenues. The Company agreed at hearing to ORS's proposed adjustment in this regard.

(2) Position of ORS: ORS proposed to adjust Utility/Commission taxes and Gross Receipts taxes by a factor of .01073326 to account for increases in Commission and ORS administration costs and a revenue tax from the Department of Revenue resulting from upward adjustments in revenue. This resulted in an adjustment to this expense item of \$2,656.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(P) Income Taxes:

(1) Position of CWS: CWS proposed to adjust taxes for accounting and pro forma adjustments. CWS used a 5% rate for state taxes and a 34% rate for federal taxes.

(2) Position of ORS: ORS also proposed to adjust for the effect of income taxes after accounting and pro forma adjustments. Like CWS, ORS used a 5% rate for state taxes and a 34% rate for federal taxes.

(3) Decision of the Commission: The Commission adopts the method proposed by the Company and ORS to adjust taxes for accounting and pro forma adjustments. The Commission finds that a 5% rate for state taxes and a 34% rate for federal taxes is appropriate as those are the actual tax rates that apply to CWS. The methodology is adopted for use in this proceeding, but the actual adjustments will vary from the proposed adjustments as the

adjustments adopted herein are different than the adjustments used by the parties in their calculations. Based on the adjustments adopted herein, the Commission approves an adjustment for Income Taxes of \$399,699 for the tax effect of accounting and pro forma adjustments.¹⁰

(Q) Interest on Customer Deposits:

(1) Position of CWS: The Company did not propose an adjustment for this item, but agreed at hearing with the adjustment proposed by ORS in this regard.

(2) Position of ORS: ORS proposed an adjustment to annualize Interest on Customer Deposits by using the ORS verified amount as of June 30, 2004, of \$183,354 and by applying the Commission approved interest rate of 3.5%. ORS computed annualized Interest on Customer Deposits of \$6,417 less the per book amount of \$9,728 for an adjustment of (\$3,311).

(3) Decision of the Commission: The Commission adopts the adjustment agreed to by the Company and ORS. This adjustment annualizes the Interest on Customer Deposits at the end of the test year at the interest rate of 3.5%, which is the Commission approved rate for interest on customer deposits.

¹⁰ Our analysis of this expense Item, as well as our analysis of expense Item T, is affected by our determination of interest expense. However, because we have heretofore only recognized interest expense itself as an allowable expense in cases in which we have employed the operating margin methodology (*see, e.g., In re Application of Palmetto Utilities, Inc.*, Order No. 97-699, Docket No. 96-376-S, August 12, 1997), we will address the Company's interest expense in the portion of our order calculating the resultant operating margin as required by S.C. Code Ann. § 58-5-240(H) (Supp. 2004). See n. 11, *infra*

(R) Allowance for Funds Used During Construction (AFUDC):

(1) Position of CWS: CWS proposed an adjustment of (\$17,756) to remove the Allowance for Funds Used During Construction ("AFUDC") from net income since it did not include Construction Work in Progress (CWIP) in rate base.

(2) Position of ORS: ORS agreed with the Company's proposed adjustment

(3) Decision of the Commission: The Commission adopts the adjustment on this item agreed to by the Company and ORS.

(S) Taxes Other Than Income— Proposed Increase

(1) Position of CWS: The Company proposed to increase Taxes Other Than Income by \$32,679 to reflect the effect of the proposed increase. At hearing, CWS agreed to the ORS position on this item.

(2) Position of ORS: ORS proposed that Taxes Other Than Income be adjusted to reflect the effect of the proposed increase, but used a factor of 0.010733226 (0.007733226 for the Commission and ORS and 0.003 for the Department of Revenue) to arrive at an adjustment of \$19,486.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(T) Income Taxes – Proposed Increase

(1) Position of CWS: The Company proposed that Income Taxes be established using current tax rates on calculated taxable income, which yields \$659,765 in allowable income tax. At hearing, the CWS agreed with the ORS position on this item.

(2) Position of ORS: ORS proposed that Income Taxes be established after taking into account the proposed increase, which yields \$569,502 in allowable income tax.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

Summary of Adopted Adjustments to Expenses:

The total effect of the adjustments to test year expenses adopted herein increase Operating and Maintenance Expenses by \$160,533, decrease General and Administrative Expenses by (\$67,974), increase Depreciation and Amortization Expenses by \$14,890, increase Taxes Other Than Income by \$271,224, increase Income Taxes by \$117,583, reduce Interest on Customer Deposits by (\$3,311), increase extraordinary retirement expense by \$29,924 and reduce AFUDC by (\$17,756). The net effect of the adjustments adopted herein on Total Operating Expenses is to increase Total Operating Expenses by \$52,768. Thus, operating expenses for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences are \$5,276,647.

The following table indicates the Company's gross revenues for the test year after adjustments approved herein, under the presently approved rate schedules; the Company's operating expenses for the test year after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences approved herein; and the rate of return on rate base under the presently approved schedules for the test year:

TABLE B

	<u>Before Increase</u>
Operating Revenues	\$5,674,555
Operating Expenses	<u>5,276,647</u>
	\$ 397,908
ADD: Allowance for Funds Used During Construction	0
Customer Growth	<u>7,184</u>
TOTAL INCOME FOR RETURN	<u>\$ 405,092</u>
Return on Rate Base	<u>2.71%</u>

12. The appropriate rate base for CWS for the test year after accounting and pro forma adjustments and adjustments for known and measurable occurrences outside the test year is \$14,940,867.

The evidence supporting this finding is contained in the Company's application and in the testimonies of Company witness Lubertozi and ORS witness Scott. ORS offered certain adjustments to the Company's proposed rate base which the Company accepted. [Scott Pre-filed Revised Direct testimony, Tr. p. 443, l. 16 - p. 446, l. 21; Lubertozi Rebuttal Pre-filed testimony, Tr. p. 490, ll. 19-22, Tr. p. 491, ll. 10-14.] No other party of record offered testimony pertaining to the Company's rate base or proposed adjustments thereto. The adjustments to rate base agreed to by the Company and ORS are as follows:

(A) Removal of Wells

(1) Position of CWS: CWS proposed to remove from gross plant in service wells no longer used and useful in accordance with our last rate case order for the Company. See Item L, above. The CWS proposal of (\$277,315) included depreciation expense and did not take into account the plant costs for Westside Terrace. At hearing, CWS agreed with ORS's proposed adjustment.

(2) Position of ORS: ORS proposed to exclude \$10,804 of depreciation expense since the wells are not longer in service and to include plant costs of \$11,118 for Westside Terrace for a total adjustment to gross plant in service of (\$299,237).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(B) Excess Book Value

(1) Position of CWS: CWS proposed to remove Excess Book Value carried forward from the Company's last rate case. CWS calculated the amount of this adjustment to be (\$941,517) based upon a carry forward balance of \$978,199 amortized at 1.50%. At hearing, CWS agreed to the calculation for this item proposed by ORS.

(2) Position of ORS: ORS agreed that Excess Book Value should be removed using a 1.50% amortization rate, but calculated the carry forward balance to be \$1,026,646, which results in an adjustment of (\$924,905).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(C) Plant Sample Items

(1) Position of CWS: Per the order in the Company's last rate case, CWS proposed to remove plant sample items from rate base since the adjustment was not made per books in the amount of (\$9,108). At hearing, CWS agreed with the ORS calculation of this adjustment.

(2) Position of ORS: ORS also proposed an adjustment to rate base to remove plant sample items, but calculated the adjustment amount to be (\$8,957) to correct an addition error.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(D) Plant Additions

(1) Position of CWS: CWS proposed to adjust for plant additions.

(2) Position of ORS: ORS agreed that known and measurable plant additions providing service to present customers should be included and verified this amount to be \$696,396.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment as calculated by ORS.

(E) Vehicles for New Employees

(1) Position of CWS: CWS proposed an adjustment of \$138,000 to include seven (7) new vehicles for new employees. See Items A and C, above. At hearing, CWS agreed with the adjustment proposed by ORS in this regard.

(2) Position of ORS: ORS proposed that an adjustment of \$82,829 be allowed for four (4) of the documented new vehicles to be utilized by the four (4) new employees which had been hired by the time of hearing.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(F) Pro Forma Plant

(1) Position of CWS: CWS proposed an adjustment for other pro forma plant of \$1,918,185.

At hearing, CWS agreed with the ORS position on this adjustment.

(2) Position of ORS: ORS proposed that no adjustment be allowed since the pro forma plant had not been placed into service as of December 31, 2004 and no known and measurable data supported making the adjustment.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(G) Capitalized Wages

(1) Position of CWS: CWS did not propose an adjustment for this item, but agreed at hearing to ORS's proposed adjustment.

(2) Position of ORS: ORS proposed an adjustment of \$50,685 to book to plant the portion of operators' wages, taxes and benefits associated with capital projects.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(H) Accumulated Depreciation

(1) Position of CWS: The Company proposed an accumulated depreciation adjustment of \$35,529 for removal of the wells, excess book value and post June 30, 2004 plant additions. At hearing, CWS agreed to the ORS position on this adjustment.

(2) Position of ORS: ORS proposed to adjust accumulated depreciation by (\$26,705) consistent with its annualized depreciation expense calculation. ORS further proposed that accumulated depreciation for wells and plant sample items from the last rate case totaling \$26,939 be removed resulting in a net adjustment of \$234.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(I) Cash Working Capital

(1) Position of CWS: CWS proposed to adjust cash working capital based on pro forma expense by \$50,343. At hearing, CWS agreed to the position of ORS on this adjustment.

(2) Position of ORS: ORS proposed an adjustment to cash working capital based on pro forma expenses excluding Taxes Other Than Income as a working capital item since that is ordinarily an accrual that does not require a cash outlay and CWS would have collect it from customers in advance of paying certain taxes. The resultant adjustment is (\$46,496).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(J) Water Service Corporation (WSC) -Rate Base

(1) Position of CWS: CWS proposed an (\$8,457) adjustment to the WSC rate base which includes deferred expenses from the last rate base. At hearing, CWS agreed to the ORS position on this item.

(2) Position of ORS: ORS agreed that the WSC rate base should be adjusted, but proposed that the deferred expenses allocated to the Company in its last rate case be removed from the WSC rate base verified by ORS on the ground that certain deferred charges allowed in expenses should not be permitted in rate base to permit a sharing of expenses between customer and stockholder. The resultant adjustment is (\$2,609).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(K) Advances in Aid of Construction

(1) Position of CWS: The Company did not propose an adjustment to this item, but agreed at hearing to the ORS position in this regard.

(2) Position of ORS: ORS proposed to remove Advances in Aid of Construction of \$1,600 from Rate Base, which are owed to the customer, on the ground that CWS should not be permitted to earn a return on customer supplied funds.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(L) Customer Deposits

(1) Position of CWS: CWS included \$245,763 in rate base that consisted of accrued interest owed to customers on deposits. At hearing, CWS agreed to the ORS position on this item.

(2) Position of ORS: ORS proposed to exclude interest accrued and due customers on deposits on the ground that a return should not be permitted on customer supplied funds. The resultant adjustment would be (\$245,763).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

Summary of Adopted Adjustments to Rate Base:

The total effect of the adjustments to rate base adopted herein reduce Gross Plant in Service by (\$402,829), increase Accumulated Depreciation by \$234 [thereby resulting in a reduction to Net Plant in Service to (\$402,595)], reduce Cash Working Capital by (\$46,496), reduce WSC rate base by (\$2,609), reduce Advances in Aid of Construction by (\$1,600) and reduce Customer Deposits by (\$245,763). The total of the adjustments adopted herein reduce total rate base by (\$699,063). Thus, after the adjustments adopted herein, as adjusted rate base is \$14,940,867. The following table indicates the Company's rate base for its jurisdictional operations in South Carolina after accounting and pro forma adjustments approved herein:

TABLE C

Gross Plant in Service	\$36,704,218
LESS: Accumulated Depreciation	<u>(4,781,663)</u>
Net Plant in Service	31,922,555
ADD:	
Cash Working Capital	521,361
Water Service Corp. – Rate Base	127,824
DEDUCT:	
Advances in Aid of Construction	(1,600)
Contributions in Aid of Construction	(15,195,347)
Plant Acquisition Adjustment	(482,719)
Accumulated Deferred Income Taxes	(1,522,090)
Customer Deposits	<u>(429,117)</u>
TOTAL YEAR END RATE BASE	<u>\$14,940,867</u>

13. A customer growth adjustment using the method for calculating customer growth as proposed by ORS is appropriately included in computing the income requirement of CWS.

The evidence supporting this finding is contained in the testimonies of Company witness Lubertozzi and ORS witness Scott. [Scott Pre-filed Revised Direct testimony, Tr. p. 448, ll. 7-8; Hearing Exh. No. 19, p. 20; Lubertozzi Rebuttal Pre-filed testimony, Tr. p. 490, ll. 19-22, p. 491, ll. 10-14.] No other party of record offered testimony pertaining to a growth adjustment. ORS computed customer growth, as adjusted, of \$7,184.

The Commission adopts the customer growth methodology as proposed by the ORS to include the adjustments adopted herein. ORS's adjustment is applied to Net Operating Income. As the ORS's customer growth adjustment is applied to Net Operating Income, the adjustment attributes an equal contribution to net income by each customer added. By applying the

adjustment to Net Operating Income, ORS's customer growth adjustment recognizes growth in both revenues and expenses.

In *Porter v. South Carolina Public Service Commission*, 328 S.C. 222, 493 S.E.2d 92 (1997), the Supreme Court of South Carolina stated "adjustments for known and measurable changes in expenses are within the discretion of the Commission. Absolute precision is not required so long as adjustments are 'known and measurable' within a degree of reasonable certainty." The Commission finds that the ORS's adjustment for customer growth meets this definition as stated by the Supreme Court. Calculation of additional revenues from additional customers may be made quite easily. However, calculation of expenses associated with the addition of customers is not as straightforward. While it would be difficult to calculate the precise amount of expenses that the addition of one customer would add, it does not make sense to ignore expenses altogether when looking at customer growth. Some expenses may increase proportionally with the addition of customers while other expenses may not increase at a proportional rate. While the ORS's adjustment may not calculate increase in expenses with absolute precision, the ORS's adjustment, which is applied to Net Operating Income and which therefore applies to both revenues and expenses, is a reasonable adjustment that comes with a "reasonable degree of certainty."

14. The income requirement for CWS, using the return on rate base of 9.00% found appropriate in this Order and the adjusted rate base of \$14,940,867, is \$1,344,674.

Under rate of return on rate base regulation, the Commission must approve an income requirement that will permit the Company to cover operating costs and provide an opportunity to

earn the approved rate of return on the rate base. The determination of the income requirement requires a calculation using approved Operating Revenues and approved Operating Expenses to determine Net Operating Income for Return. Net Operating Income for Return is then increased for approved AFUDC and approved Customer Growth resulting in Total Income for Return. The following table illustrates the calculations of CWS's Total Income for Return:

TABLE D

	<u>After Increase</u>
Operating Revenues	\$7,015,913
Operating Expenses	<u>5,690,886</u>
Net Operating Income For Return	1,325,027
ADD: Allowance for Funds Used During Construction	0
Customer Growth	<u>19,647</u>
TOTAL INCOME FOR RETURN	<u>\$1,635,047</u>
 Return on Rate Base	 <u>9.00%</u>

As demonstrated on Table D, Total Income for Return after the increase approved herein is \$1,635,047.

15. In order for CWS to have the opportunity to earn its income requirement of \$1,635,047, CWS must be allowed additional revenues totaling \$1,341,358.

In order for the Company to have the opportunity to earn the 9.00% rate of return on rate base approved herein, the Commission must increase revenues sufficient to achieve a Total Income for Return of \$1,635,047, as calculated in Finding of fact No. 13. The additional

revenue calculated for the Company to have the opportunity to earn its approved rate of return of 9.00% requires an increase of \$1,341,358.

16. In designing rates for CWS, a uniform rate schedule for customers is appropriate. Accordingly, the sewer rates for customers in Lincolnshire service area, I-20 service area, Lexington service area, Kings Grant service area, and Teal on the Ashley service area will be increased to a level commensurate with those to be charged to other customers.

Upon determination of the revenue requirements for a utility in a ratemaking proceeding, the next step is the determination of the specific rates or rate structure that will yield the required revenues. A generally accepted principle is that proper utility regulation requires the exercise of control over a utility's rate structure. *The Regulation of Public Utilities, supra*.

In designing rates for the Company, the Commission strives to set rates that are "just and reasonable" and without undue discrimination. In the case before the Commission, CWS has requested uniform rates. The Commission finds that such a uniform rate schedule is fair and reasonable and is in the best interests of the customers and CWS. In the Company's last rate case, it did not seek increases for those customers in the Lincolnshire service area, the I-20 service area, and the Lexington service area. Order No. 2001-887 at 68. The reasoning for this divergence in rates as expressed by CWS's witness in that proceeding was that the status of the Company's operation, and even its ownership of the systems, serving those areas was in a state of flux. *Id.* Those systems were operating under expired NPDES or ND permits and were the subject of either current or potential litigation. *Id.* The uncertainty of the outcome of the issues involving those service areas led CWS not to seek rate relief for sewer treatment in those service

areas. Id. Because the Commission felt that similar circumstances appertained with respect to the Company's Kings Grant and the Teal on the Ashley service areas, we found it appropriate to exclude the customers in those service areas from the sewer rate increase as well as those excluded by CWS's application. In short, our departure from a uniform rate structure in the Company's last rate case was warranted by special facts and circumstances. *See August Kohn & Co. Inc. v. Public Service Comm'n*, 290 S.C. 409, 313 S.E.2d 630 (1984). However, the Commission concludes that these special facts and circumstances no longer exist.

At hearing in the instant proceeding, Company witness Lubertozi observed that even though some of the circumstances regarding the excluded sewer service areas had not changed since the last rate case, continued exclusion of these areas was no longer warranted. [Lubertozi Pre-filed Direct testimony, Tr. p. 291, ll. 5 - 26.] Mr. Lubertozi stated that the Company's position in this regard in the last rate case was predicated upon its belief that uncertainties regarding the ultimate disposition of these sewer systems would have been resolved prior to the instant filing. [Id., Tr. p. 291, l. 28 - p. 292, l. 5.] That belief has now been disproven and no other party of record produced evidence to demonstrate that these uncertainties would be resolved at any near date. Thus, rather than being a "special" circumstance as contemplated in *August Kohn, supra*, the evidence of record demonstrates that, in any given rate case, the Company may be expected to have unresolved issues regarding future ownership and/or interconnection of its treatment facilities. Moreover, the application reveals that the Company currently holds valid permits from DHEC for the operation of all five of these sewer facilities. [See Application Exhibit "C."]

We conclude that the further exclusion of these five sewer service areas from rate adjustments is not warranted. We are mindful that the impact of the increase in sewer rates approved by this order on customers in these areas will be greater than that felt by other customers. However, countervailing that is the fact that the customers in these five areas will have enjoyed lower sewer rates than the Company's other sewer customers for nearly four (4) years by the time the rates approved herein will become effective. Moreover, to continue excluding customers in these areas from rate adjustments would foster undue discrimination against other customers. *Cf., The Regulation of Public Utilities, supra*, at 171. It is incumbent upon us to approve rates which **fairly** distribute the Company's revenue requirement. *Seabrook Island POA v. S.C. Public Service Comm'n*, 303 S.C. 493, 401 S.E.2d 672 (1991). In light of the foregoing, a fair distribution of the Company's revenue requirement cannot exist if large numbers of sewer customers continue to be excepted from rate adjustments and we decline to do so.

17. The resultant operating margin for CWS, based upon the adjustments and rates approved herein, is 14.12%. S.C. Code Ann. Section 5-240(H) (Supp.2004) provides, in part, that "[t]he [C]ommission shall specify an allowable operating margin in all water and wastewater orders." Based upon the rate of return on rate base approved herein and the revenues and expenses also approved herein, the corresponding operating margin is calculated to be 14.12%. The following Table reflects an operating margin of 14.12%:

TABLE E

Operating Revenues	\$7,015,913
Operating Expenses	<u>5,690,886</u>
Net Operating Income	\$1,325,027
ADD: Allowance for Funds Used During Construction	0
Customer Growth	<u>19,647</u>
Total Income for Return	<u>\$1,635,047</u>
Operating Margin (After Interest Expense of \$644,242) ¹¹	<u>14.12%</u>

18. The Company's requested modifications to its water and sewer rate schedule provisions pertaining to billing tenants for the convenience of a landlord and the addition of a provision to its water rate schedule for implementing a cross-connection control program are appropriate as being in the public interest and are hereby approved.

The evidence supporting this finding of fact is contained in the Company's application, the testimony of its witness Haas [Haas Pre-filed Direct Testimony, Tr. p. 325, l.25 - p. 327, l. 2], and the testimony of ORS witness Hipp [Hipp Pre-filed Direct Testimony, Tr. p. 420, ll. 1-14.] As noted by both witnesses, an amendment to S.C. Code Ann. § 27-33-50 (Supp. 2004) requires a revision to the tenant billing provisions of the Company's rate schedule. We further

¹¹ CWS proposed to include interest expense of \$735,428 based upon the Company's as adjusted rate base, 59.23%/40.07% debt/equity ratio and a cost of debt of 7.28%. ORS proposed to include interest expense of \$644,242, which results in an adjustment to the Company proposal of (\$91,186), to reflect usage of the adjusted rate base and not the Company pro forma rate base.

agree with these witnesses that DHEC regulation 24A S.C. Code Ann. R. 61-58.7.F.8 prohibits maintenance of a cross-connection to a public water system unless a cross-connection inspection is performed annually on required backflow prevention devices. Because it is the decision of a customer to install a cross-connection, the burden of compliance with the DHEC regulations in this regard should be borne by the customer. Given that ORS supports these modifications, and no other party opposed them, we find the Company's requested rate schedule modifications to be in the public interest and approve same.

IV. CONCLUSIONS OF LAW

Based upon the Findings of Fact as contained herein and the record of the instant proceeding, the Commission makes the following Conclusions of Law:¹²

1. Rate of return on rate base is the appropriate guide for the Commission to use in determining the lawfulness of the rates of CWS and in fixing of just and reasonable rates for CWS to charge its customers in South Carolina.

2. A fair rate of return on rate base for the operation of CWS in South Carolina is 9%. This rate of return is calculated using a capital structure of 59.23% debt and 40.07% equity, a cost of debt of 7.28%, and a return on equity of 11.50%. Based on the discussion and analysis of the Commission as detailed in this Order, these components of capital structure, cost of debt,

At hearing, CWS agreed to the ORS position on this item. The Commission adopts the ORS position on this adjustment which was agreed to by the Company.

¹² The Commission's analyses which give rise to the Conclusions of Law are contained in the discussions of Section III of this Order.

and cost of equity and the resulting rate of return on rate base produce a fair and reasonable rate of return which the Company should have the opportunity to earn.

3. For the test year of June 30, 2004, the appropriate operating revenues, under present rates and as adjusted in this Order, are \$5,674,555, and the appropriate operating expenses, under present rates and as adjusted in this Order, are \$5,276,647.

4. Using the rate base as adjusted in this Order of \$14,940,867 and the return on rate base of 9% found to be fair and reasonable in this Order, the income requirement for CWS is \$1,635,047.

5. In order for CWS to have an opportunity to earn the return on rate base found reasonable and approved in this Order and to meet the income requirement, CWS must be allowed additional revenues of \$1,341,358.

6. The rates approved in this Order are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of the Company.

7. Based on the adjustments approved herein and the increase in rates approved herein, the appropriate operating margin for CWS on its South Carolina operations is 14.12%.

8. The Company's requested modifications to certain terms and conditions of service in its rate schedule is in the public interest.

IT IS THEREFORE ORDERED THAT:

1. CWS is granted a rate of return on rate base for its water and sewer operations in South Carolina of 9%.

2. The schedule of rates and charges attached hereto as Appendix A, which include the Company's proposed modifications, are hereby approved for service rendered on or after the date of this Order. Further, the schedules are deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2004).

3. Should the schedules approved herein and attached hereto as Appendix A not be placed in effect until three (3) months from the effective date of this Order, the schedules shall not be charged without written permission from the Commission.

4. CWS shall maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class A Water and Sewer Utilities, as adopted by this Commission.

6. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Randy Mitchell, Chairman

ATTEST:

G. O'Neal Hamilton, Vice Chairman

(SEAL)